



Purposeful Companies

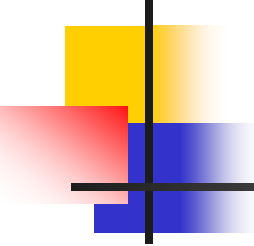
Alex Edmans, London Business School

Oliver Hart Conference on
New Frontiers in Corporate Governance

October 2022



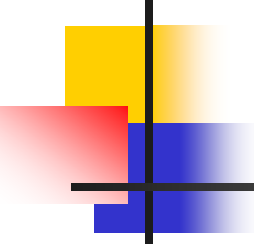
I. Do Companies Need a Purpose?



A World Without Purpose: Friedman (1970)

- “The social responsibility of business is to increase its profits ...”
- “... focusing totally on making money, and forgetting about any concerns for employees, customers or society”
 - Steve Denning, Forbes

A World Without Purpose: Friedman (1970)



- “It may well be in the **long run** interest of a corporation that is a major employer in a small community to devote resources to providing amenities to that community or to improving its government. That may make it easier to attract desirable employees, it may reduce the wage bill”

Do Companies Need a Purpose?





Study on directors' duties and sustainable corporate governance

FINAL REPORT

ABSTRACT (EN)

The focus of corporate decision-makers on **short-term shareholder value maximisation** rather than on the long-term interests of the company reduces the long-term economic, environmental and social sustainability of European businesses.



Short-Term Shareholder Value

- Finance 101: shareholder value is an inherently long-term concept

$$P_t = E \left[\sum_{t=0}^{\infty} \frac{C_t}{(1+r)^t} \right]$$

- The solution may be *more* shareholder capitalism



Where Friedman Fails

- Externalities
 - Edmans (2020, ProMarket): “What Stakeholder Capitalism Can Learn from Milton Friedman”
 - Zingales (2020, ProMarket): “Friedman’s Legacy: From Doctrine to Theorem”
 - Edmans (2023, WSJ): “What Social Responsibilities Should Companies Have? A New Approach”
- Bounded Rationality



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BANKI KUU YA KENYA
CENTRAL BANK OF KENYA

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LEGAL TENDER FOR TWENTY SHILLINGS

SHILINGI ISHIRINI



DANIEL TOROITICH ARAP MOI
PRESIDENT OF THE REPUBLIC OF KENYA



1st JANUARY 1981

FOR THE BOARD OF DIRECTORS

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[Signature]

GOVERNOR

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MEMBER

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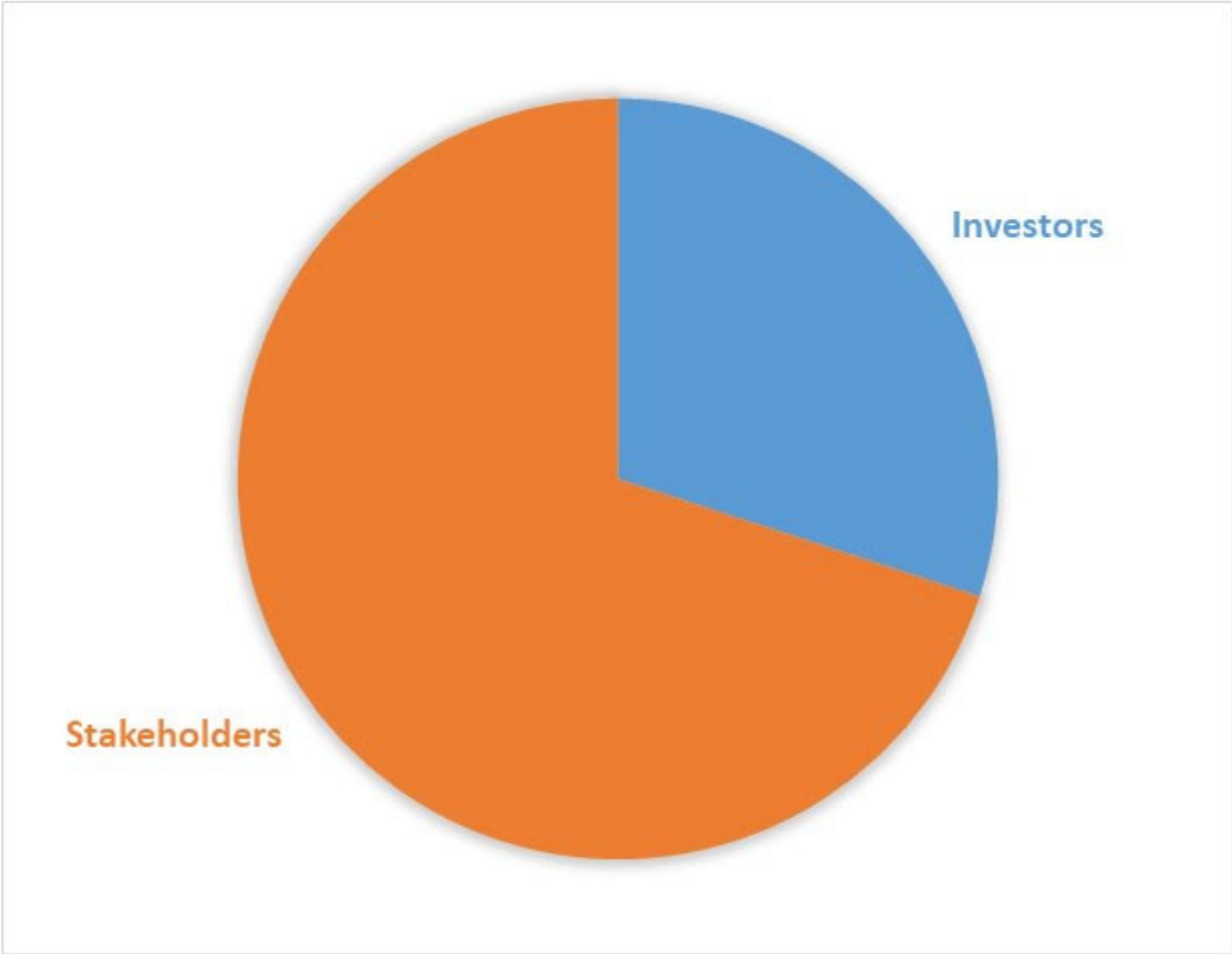




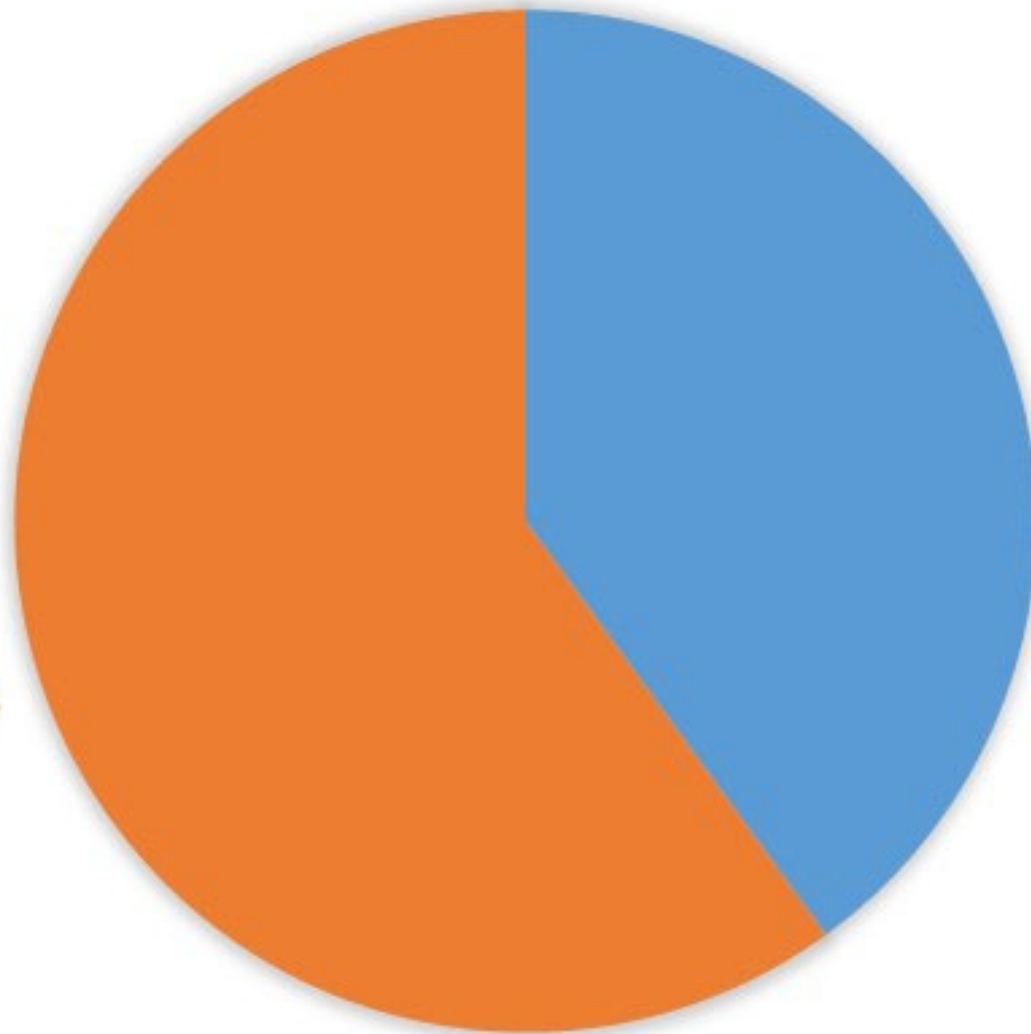
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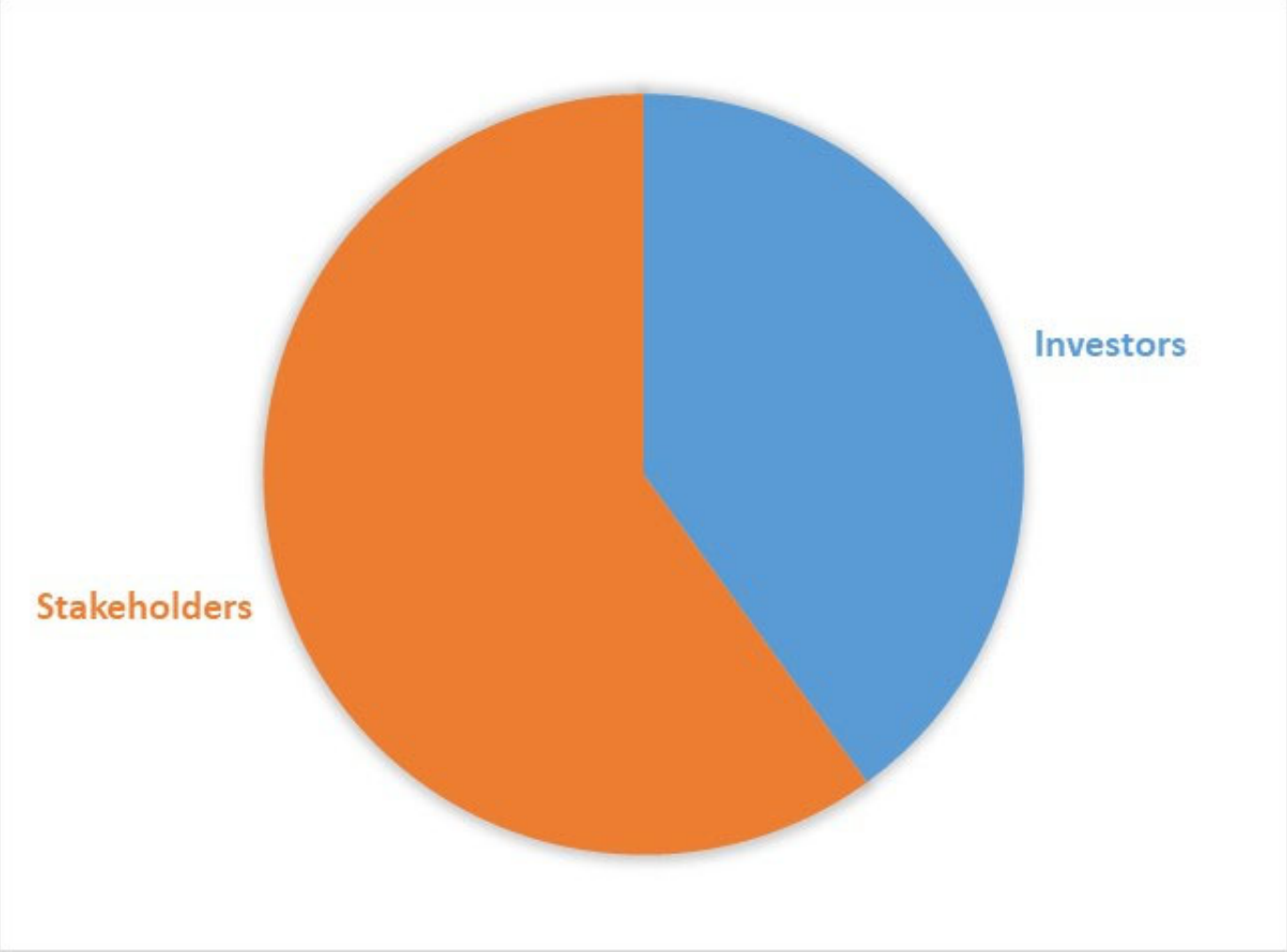
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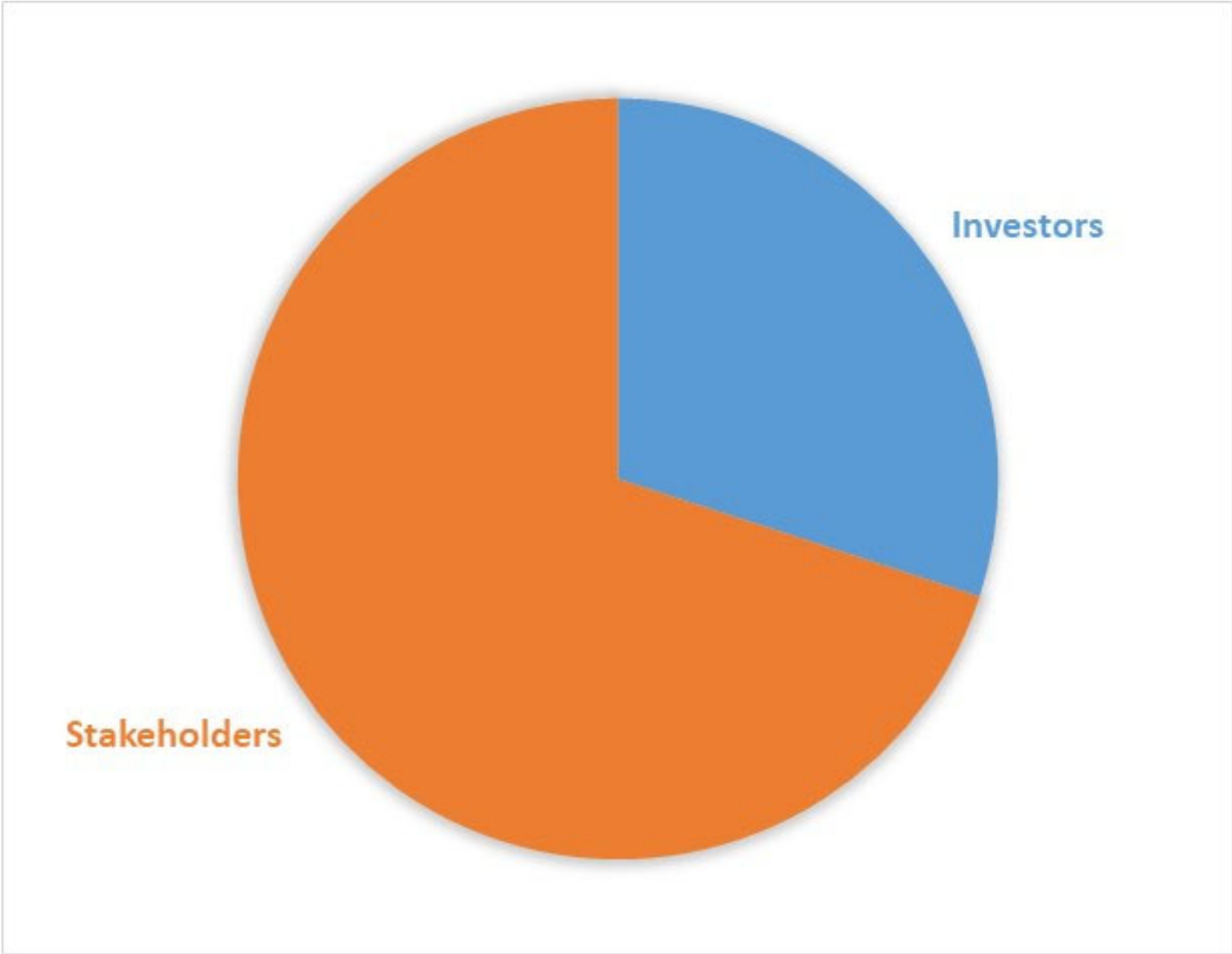


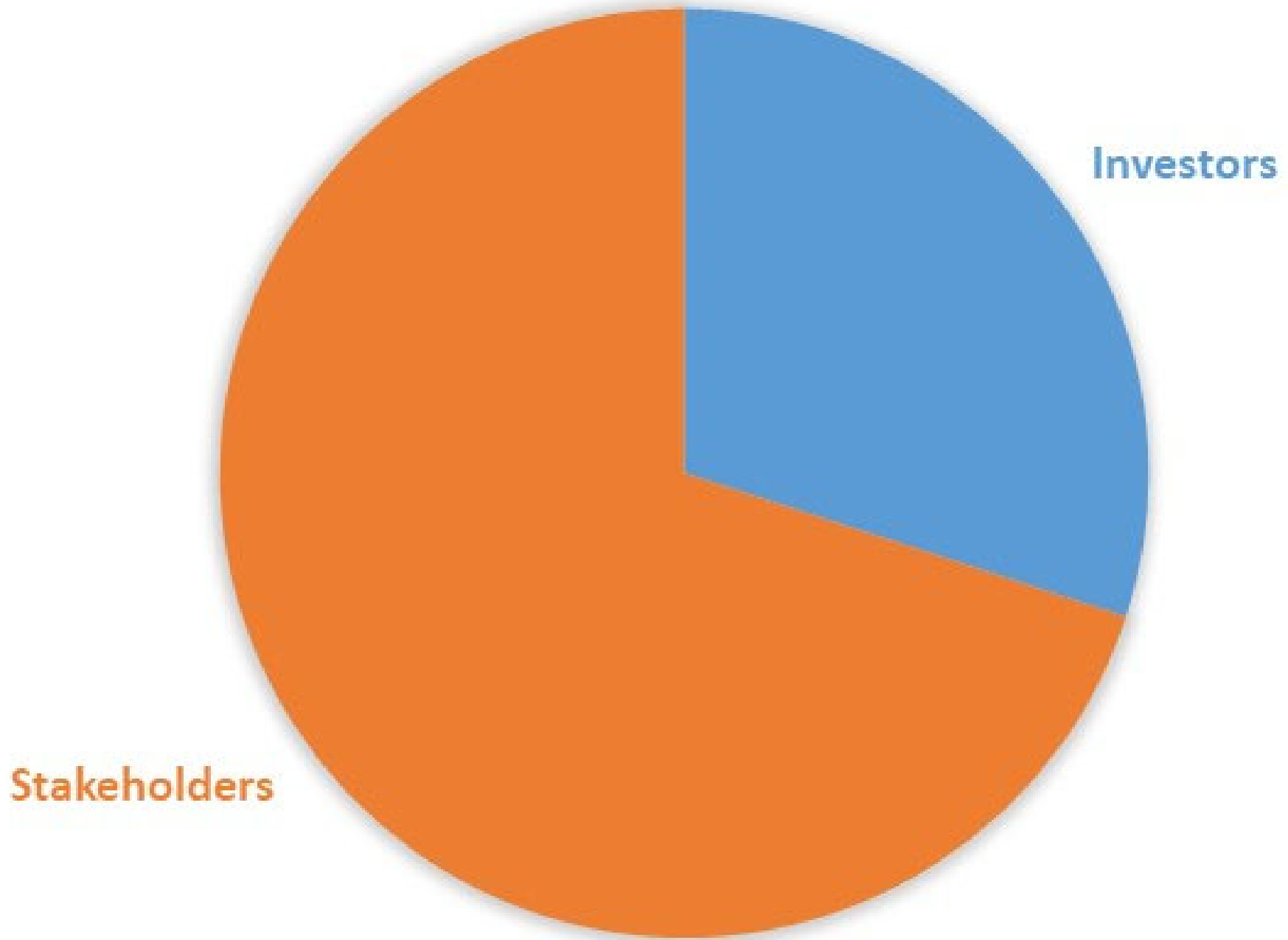
Stakeholders



Investors









II. Measuring Purpose



US Education in 2001

- No standardised measures of school performance
 - Schools had no incentives to improve
 - School districts couldn't tell which schools were underperforming and needed remedial action
 - School districts didn't know where to allocate budget
- No Child Left Behind Act
 - Standardised tests each year
 - If no Adequate Yearly Progress in two straight years, labelled as "In Need of Improvement"
- Hit the target, miss the point
 - 71% of school districts cut at least 1 subject
 - Teaching to the test



Global Business in 2023

- No standardised measures of school performance
 - Schools had no incentives to improve
 - School districts couldn't tell which schools were underperforming and needed remedial action
 - School districts didn't know where to allocate budget
- Few standardised measures of company performance
 - Companies have no incentives to improve
 - Investors can't tell which companies are underperforming and needed engagement
 - Investors don't know where to allocate capital



The Tyranny of Metrics

- Companies report standardized metrics
- Investors choose stocks based on these metrics
- Clients choose investors based on these metrics

- Managing to the metric, undermining the reason for purpose to begin with. **Purpose is not ESG**
 - Generic, not tailored. Don't take materiality into account
 - "Do no harm", not "actively do good"
 - Quantitative: hit the target, miss the point. Like diversity vs. DEI (Edmans, Flammer, and Glossner, 2023)
 - Looking under the lamppost – we look where we can see, even if it's not relevant



The Solution

- Is not more complex metrics
 - Milarex had 2022 revenue of €387m, but additional monetized consumer impact of €587.9m
- Is not to scrap metrics
- Material metrics (tailored KPIs; Balanced Scorecard)
- Understand what metrics capture and don't capture
 - Like Google Scholar cites
- Move beyond metrics (processes, inputs)
- Resist the temptation to reduce everything to a set of numbers (or, even worse, one number)
- View ESG like any other intangible



Further Reading



ORIGINAL ARTICLE |  Open Access |  

The end of ESG



ORIGINAL ARTICLE |  Open Access |  

The purpose of a finance professor